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SUBJECT: South China Fast Food Restaurants Quelling Fears
of Avian McFlu

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11. (SBU) SUMMARY: A recent look at how KFC and McDonald's are responding to concerns about avian influenza (AI) -- in a region of China particularly obsessed with food -- found unbridled optimism on the part of these companies about their efforts to inform the Chinese public about the safety of their products. KFC reports that while sales initially dipped for reasons not entirely clear, they are back to normal. McDonald's contends that sales have not suffered at all because of AI, and are even up. Both companies have undertaken slick multimedia marketing campaigns to demonstrate that it is still safe to consume poultry, and consumers appear to be satisfied that their products are indeed safe. We still do not have a handle on the full extent of concern about AI in the region because of the tight government control over reporting on this topic, but our contacts appear to range from not-very to moderately concerned. This could all change quickly, however, if further outbreaks occur and if they hit close to home. END SUMMARY.

12. (SBU) Guangzhou is arguably the most food-obsessed city in China. The Cantonese have developed a strong attachment to food, especially to the local cuisine, which they will passionately argue is among the most refined in the world. Indeed, a study published by Xinhua in November 2005 found that while the average Chinese spends \$71 on food and drinks annually, residents in Guangzhou spend \$512 per capita on dining out a year -- over seven times the national average. Shanghai residents ranked a distant second, spending \$187 per capita annually. The study also noted that more and more urban Chinese prefer to dine out rather than to eat at home, a trend clearly evident in Guangzhou's packed eateries. One would thus expect the appearance of AI in China to provoke a degree of concern about food safety, reflected perhaps in a decline in poultry consumption.

13. (SBU) Given the huge popularity of American fast food chains in Guangzhou, Econoff contacted officials at KFC and McDonald's to learn how each has addressed the issue of AI as it relates to its consumers. Econoff became curious about this issue after spotting, during a recent visit to a local McDonald's, a prominently displayed stand up tabletop advertisement detailing the steps McDonald's has taken to ensure its chicken products are safe.

The Big Boy on the Fast Food Block

14. (U) KFC is the dominant player in the fast food market in China, and thus would have a lot to lose if AI concerns began to affect business. KFC, which began operating in China in 1987, is owned in China by Yum! Restaurants China (Yum China) -- a subsidiary of U.S.-based Yum Brands Inc. Yum China also owns Pizza Hut, but the bulk of its sales in China come from its KFC stores, according to press reports. KFC opened its 1,500th restaurant in China in late 2005 and the company reportedly expects to open roughly 400 new restaurants in China in 2006. Headquartered in Shanghai, Yum China posted more than USD 200 million in operating profit in 2004, surpassing Yum Brands Inc. earnings that year for its entire U.S. KFC chain, according to Western press reports.

Sales Are Disappointing, But Why?

15. (U) In November 2005, Yum publicly reported that its October 2005 sales in China rose just 8%. In January 2006, Yum reported a 1% drop in November 2005 sales in China, saying sales were being hurt by consumer concerns about AI,

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according to press reports. (Note: After conversion to U.S. dollars, the unit posted a 1% sales increase. The company maintains a long-term goal of posting roughly 20% annual sales increases in China. End Note.) In February 2006, the press reported financial analysts' concerns about declining sales and margins in China, and other industry analysts have commented that news about AI has weighed on overall consumer sentiment towards chicken in China. Some analysts speculate that the sales slump, however, could be attributed in part to a KFC food safety scare in March 2005 in which it became known that a banned food dye was being used in some KFC dishes, and/or to the unpopularity of a fried chicken steak item that did not resonate with consumers.

KFC On the Offensive, While Planning for the Worst

16. (U) Then, in early February 2006, David Novak, the chairman and chief executive of Yum Brands Inc., said publicly that KFC's business in China had returned to "previous strong levels" and that consumers in China appear to be less concerned about AI. Novak explained that customers seemed to be getting used to news about AI and were becoming less concerned about eating fully cooked chicken, which KFC has been aggressively communicating is safe to eat. In an apparent effort to be prepared for the worst, however, Western press reports from November 2005 note that Yum was working on television ads that could be rolled out globally if an AI epidemic emerges among humans. The ads will reportedly simply state that eating fully-cooked chicken is safe.

The KFC Food Safety Story

17. (SBU) The local KFC office put Econoff in touch with Lily Long, a public affairs manager in Shanghai, to learn more about KFC's strategy to manage AI concerns. Long explained that, although customers were concerned about eating chicken

after AI outbreaks in October 2005, the Chinese government and the World Health Organization (WHO) have both since conducted a great deal of public education on AI and its prevention. For its part, KFC intensified education on chicken safety through its website, TV commercials, and in-store posters and placemats. In fact, a colorful placemat put on each tray features cartoon drawings of a happy test tube wielding scientist and KFC employees. It also details the quality-control measures undertaken by KFC to ensure food safety during every step of the process, from the selection of chicken suppliers to the final cooking of the chicken. Long opined that these measures have restored customers' confidence in eating chicken, noting that while KFC sales decreased slightly in some provinces and cities, they have recovered; Long did not provide actual figures. When asked if KFC has considered adding more non-chicken products to its line, Long simply noted that KFC has always offered non-chicken products.

¶8. (U) Long then explained how KFC ensures the quality of its roughly 30 chicken suppliers, noting that they all have good reputations, modern facilities, sophisticated management systems, and conform to Hazard Analysis and Critical Control Points (HACCP) and Chinese quality and safety standards. She pointed out that each batch of KFC chicken must have a certificate from local quarantine authorities certifying that the chicken is AI-free. (Note: A KFC executive said publicly in November 2005 that the poultry KFC buys in China and the U.S. is raised in shelters, protecting the flock from migratory birds that might carry AI. End note.) Long also explained that all KFC chicken is cooked to above 170 degrees Celsius for between 2.5 minutes to 14.5 minutes during an electronically programmed process in accordance with Chinese Health

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Ministry hygiene standards. Long also said that KFC cleans and sterilizes its facilities and equipment several times a day and has implemented the highest food safety standards in regard to the handling of raw chicken.

The Arches Are Not As Golden in China

¶9. (U) While McDonald's obviously has a huge stake in the China market and thus in educating Chinese consumers on its food safety practices, its influence in China is dwarfed by KFC. McDonald's opened its first restaurant in China in Shenzhen in 1990, three years after KFC, and today there are more than 700 McDonald's restaurants across China, as compared to KFC's 1,500. In early 2005 a McDonald's executive said publicly that the company views China as its fastest developing area, after the U.S., over the next few years. The company aims to have roughly 1,000 stores throughout China by 2008, and plans to achieve this goal by opening 200 stores per year for the next two years. McDonald's chose Guangdong's Dongguan City as the location for its first drive-thru restaurant in China, opened in December 2005.

So Will The New Drive-Thru Drive Away AI Concerns?

¶10. (SBU) Econoff spoke with Greg Gilligan, McDonald's head of government relations, and with Gary Rosen, chief of marketing and corporate affairs for McDonald's China, about McDonald's response to AI concerns in its customers. Rosen said that McDonald's chicken sales in China have not suffered because of AI; in fact, they "have been up." He speculated that this is because people trust the food quality at McDonalds, perhaps more than at other restaurants. Both officials repeatedly emphasized the quality of the supply chain that provides all McDonald's ingredients, and Rosen expanded on this by saying that McDonald's chickens come from a dedicated supplier who sells only to McDonald's and whose chickens are vaccinated and

quarantined. As for food handling, Gillian explained that McDonald's has always had specialized training for handling raw meat products (including color coded gloves for raw and cooked foods to prevent cross contamination) and that this training was sufficient in the face of AI. Rosen said that McDonald's has not introduced any new products as a result of AI, explaining that if customers continue to want chicken, McDonald's will continue to provide it.

¶11. (SBU) To make their case to the public, Rosen said that McDonald's has aired TV ads throughout China to address AI concerns. These ads offered facts about McDonald's cooking procedures and invited consumer questions, pledging to try to provide answers to reassure consumers. Rosen said that in his experience, Chinese customers want to receive a lot of details, e.g. they want to know the exact temperature at which chicken is cooked. He said that Chinese mothers, in particular, want as much information as possible so they will know exactly what their children are eating. McDonald's also uses tabletop ads and placemats in its stores to pass on the message that McDonald's chicken must pass multiple quality-control and health checks; they also explain breeding conditions and food-safety measures. When asked if McDonald's had taken a different approach to AI concerns in South China, given that this area is traditionally a breeding ground for new diseases, Rosen noted that the company has a national strategy that does not differ in the South. Despite this optimism, however, Western press reports note that McDonald's, much like KFC, is developing contingency AI plans at its Oak Brook, Illinois headquarters.

Comment: But What Do the Locals Really Think?

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¶12. (SBU) It is difficult to assess the overall level of AI concerns locally given the authorities' tight control over reporting on this issue. Econoffs have noted varying degrees of concern about AI among our contacts throughout the district. On a recent roadtrip through Guangdong and Guangxi, for example, Congenoffs found that contacts in northern Guangxi opined, when asked, that they were not concerned about AI because all chickens had been vaccinated. Their actions are perhaps more telling, however; our hosts never served chicken -- even when the town specialty was a chicken dish. In contrast, in southern Guangxi our contacts also said they were not concerned about AI, but they actually served (and ate) chicken at every meal. An unofficial polling of local residents who purchase chicken at area wet markets revealed that there has been no notable change in the price of chicken, probably an indication that local demand has not changed markedly. We expect to see the level of concern rise considerably, however, if more AI cases appear closer to home. In the meantime, local gourmands are likely to continue to enjoy their fast food chicken with a newfound appreciation for food safety measures.

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